

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE EFFECTS OF THE FEDERAL TAX)
REFORM ACT OF 1986 ON THE RATES OF) CASE NO. 9780
KENTUCKY UTILITIES COMPANY)

O R D E R

On July 1, 1987, Kentucky Utilities Company ("KU") submitted an application for rehearing in Case No. 9780. In its application, KU requested rehearing on rate base adjustments for investment tax credit ("ITC") and the Superfund tax. The adjustments proposed by KU would decrease the revenue requirements reduction by \$657,000. This amount represents \$549,000 and \$108,000 for the proposed adjustments for the ITC and Superfund tax respectively.

ISSUES ON REHEARING

Investment Tax Credit

KU stated that the Commission used an incorrect number for the test period ITC in computing the adjustment for loss of cash flow. KU believes that the correct amount to use for the ITC adjustment should be \$3,560,000¹ which represents the total ITC amortized against rate base during the test period. KU stated that this is consistent with the Commission's position that the rate base adjustments permitted must reflect actual test year

¹ Price Exhibit 3, Schedule 3, page 1, line 6.

operations and not include adjustments dependent upon the future addition of plant to the system. Further, KU stated that the methodology used to show the effects of ITC repeal as an increase in rate base rather than as an amount required to maintain cash flow is consistent with KU's method of accounting for ITC.

As an alternative, KU requested that the Commission permit an adjustment to reflect the decrease in cash flow caused by the loss of the actual ITC generated in the test period. No request for the ITC lost during the test period was presented by KU prior to this application. However, KU has now indicated that the actual test-period ITC loss was \$2,434,000.²

In its Order, the Commission stated that most utilities involved in the Federal Tax Reform Act of 1986 ("Tax Reform Act") proceedings had proposed that the effects on cash flow be recognized in determining the effect on revenue requirements. In its determination of revenue requirements, the Commission generally allowed adjustments to reflect the level of additional cash flow requirements due to the decrease in deferred taxes resulting from changes to unbilled revenue, uncollectible accounts, certain business expenses, Superfund taxes and test period ITC. The Commission allowed these adjustments since the resulting decrease in deferred taxes was based upon the application of the Tax Reform Act to actual test year operations, was unrelated to plant growth and did not create a mismatch between test-year rate base and pro forma revenues and capitalization.

² Workpaper "ITC ADJ," submitted in response to Staff Information Request No. 1.

The adjustment proposed by KU to recognize the cash flow loss from the ITC amortized during the test year does not meet the above criteria for several reasons. First, the \$3,560,000 ITC rate base amortization is not a change resulting from the Tax Reform Act. Second, the rate base for the 12-month period ending November 30, 1986, reflects ITC amortized during the test year. Third, KU's calculation of the actual rate of return earned during the test year was calculated using test-year-end rate base and therefore reflects the test-year ITC amortization as well.

The ITC repeal was retroactive to January 1, 1986. Therefore, KU and other utilities lost ITC on plant placed in service during the test period. It was this loss of cost free capital relating to ITC which the Commission determined should be recognized. As KU states, the ITC repeal will increase rate base. However, previously deferred ITC is not affected. Rather, rate base gradually increases as previously deferred ITC is amortized and the unamortized ITC balance declines.

Therefore, the Commission is of the opinion that KU should be allowed the alternative proposed ITC adjustment limited to the \$2,434,000 ITC actually lost during the test year.

Superfund Tax

KU stated in its response to Staff Information Request No. 1, that it would propose to increase tax expense by \$150,000 to \$200,000 if the Commission decided an adjustment for the Superfund tax was a proper part of the filing. However, at the public hearing, KU stated that a detailed calculation could be provided but

that nothing was reflected as an additional revenue requirement as a result of the Superfund tax.

The Commission allowed an adjustment to reflect the Superfund tax where such an adjustment was proposed in other Tax Reform Act proceedings. Therefore, the Commission is of the opinion that KU should be allowed this adjustment in the calculation of revenue requirements.

In its application, KU stated that the adjustments are in the nature of corrections and that KU believes these issues can be resolved without the necessity of another hearing. The Commission concurs with this position and has included as Appendix B the revised calculation of the reduction in revenue requirements based on the issues addressed in this Order.

The adjustments allowed on rehearing result in a decrease in revenue requirements of \$542,000. Therefore, the reduction in revenue requirements for the Phase Two rates for service rendered on and after January 1, 1988, should reflect an additional decrease of \$9,033,000.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, HEREBY ORDERS THAT:

1. The adjustments for the \$2,434,000 ITC lost during the test year and for the Superfund tax be and hereby are allowed.
2. The revenue requirements reduction reflected by KU's Phase Two rates is hereby decreased by \$542,000.
3. The rates in Appendix A be and they hereby are approved for service rendered by KU effective on and after January 1, 1988.

4. Within 30 days from January 1, 1988, KU shall file with this Commission its revised tariff sheets setting out the Phase Two rates approved herein.

Done at Frankfort, Kentucky, this 21st day of July, 1987.

PUBLIC SERVICE COMMISSION

Richard D. Hemmery
Chairman

[Signature]
Vice Chairman

[Signature]
Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9780 DATED JULY 21, 1987.

The following rates and charges are prescribed for the customers in the area served by Kentucky Utilities Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

RS
RESIDENTIAL SERVICE

RATE

Customer Charge \$ 2.75 per month

Plus an Energy Charge of:

5.551 cents per KWH for the first 100 KWH used per month.

5.092 cents per KWH for the next 300 KWH used per month.

4.681 cents per KWH for all in excess of 400 KWH used per month.

FERS
Full Electric Residential Service

RATE

Customer Charge \$ 3.75 per month

Plus an Energy Charge of:

4.738 cents per KWH for the first 1,000 KWH used per month.

4.334 cents per KWH for all in excess of 1,000 KWH used per month.

GS
General Service

RATE

Customer Charge: \$4.00 per month

Plus an Energy Charge of:

7.015 cents per KWH for the first 500 KWH used per month.

5.873 cents per KWH for the next 1,500 KWH used per month.

5.396 cents per KWH for all in excess of 2,000 KWH used per month.

CWH
Combination Off Peak Water Heating

RATE

Customer Charge \$1.00 per month
Plus All Energy at 3.152 cents per KWH per month.

O.P.W.H.
Off Peak Water Heating

RATE

Customer Charge \$1.00 per month
Plus All Energy at 3.759 cents per KWH per month.

RATE 33
Electric Space Heating Rider

RATE

For All KWH used under this schedule during each heating season at
4.413 cents per KWH.

A.E.S.
All Electric School

RATE

All KWH at 4.423 cents per KWH.

IS
Interruptible Service

RATE

Plus Energy Charge of 2.109 cents for all KWH used in the billing
month.

LP
Combined Lighting and Power Service

RATE

Plus an Energy Charge of:

- 3.333 cents per KWH for the first 500,000 KWH used per month.
- 3.084 cents per KWH for the next 1,500,000 KWH used per month.
- 2.954 cents per KWH for all in excess of 2,000,000 KWH used per month.

LCI - TOD
Large Commercial/Industrial Time-of-Day Rate

RATE

Energy Charge of 2.651 cents per KWH for all KWH used.

HLF
High Load Factor

RATE

Energy Charge of 2.713 cents per KWH for all KWH used.

MP
Coal Mining Power Service

RATE

Plus an Energy Charge of:

- 3.340 cents per KWH for the first 500,000 used per month.
- 2.990 cents per KWH for all in excess of 500,000 KWH used per month.

LMP - TOD
Large Mine Power Time-of-Day Rate

RATE

Energy Charge of 2.531 cents per KWH for all KWH used.

M
Water Pumping Service

RATE

Plus an Energy Charge of:

- 5.141 cents per KWH for the first 10,000 KWH used per month.
- 4.408 cents per KWH for all in excess of 10,000 KWH used per month.

ST. LT.
Street Lighting Service

RATE

<u>Incandescent System*</u>	<u>Load/Light</u>	<u>Rate Per Standard</u>	<u>Light/Month Ornamental</u>
1,000 Lumens (Approximately)	.102 KW/Light	\$ 2.29	\$ 2.92
2,500 Lumens (Approximately)	.201 KW/Light	2.90	3.66
4,000 Lumens (Approximately)	.327 KW/Light	4.19	5.09
6,000 Lumens (Approximately)	.447 KW/Light	5.59	6.60
10,000 Lumens (Approximately)	.690 KW/Light	7.64	9.17

Mercury Vapor

3,500 Lumens (Approximately)	.126 KW/Light	\$ 5.67	\$ 7.96
7,000 Lumens (Approximately)	.207 KW/Light	6.63	8.79
10,000 Lumens (Approximately)	.294 KW/Light	7.70	9.62
20,000 Lumens (Approximately)	.453 KW/Light	9.18	10.72

High Pressure Sodium

4,000 Lumens (Approximately)	.060 KW/Light	\$ 4.88	\$ 7.39
5,800 Lumens (Approximately)	.083 KW/Light	5.31	7.82
9,500 Lumens (Approximately)	.117 KW/Light	6.02	8.71
22,000 Lumens (Approximately)	.242 KW/Light	8.97	11.66
50,000 Lumens (Approximately)	.485 KW/Light	14.59	17.28

*NOTE: Incandescent restricted to those fixtures in service on October 12, 1982 (Except for spot Replacement).

P.O.Lt.
Private Outdoor Lighting

RATE

<u>Monthly Charge</u>	<u>Approximate Lumens</u>	<u>Type Light</u>	<u>KW Rating</u>
\$ 7.57	7,000	Mercury Vapor	.207
9.20	20,000*	Mercury Vapor	.453
14.59	50,000*	High Pressure Sodium	.485

*NOTE: Not available for urban residential home use.

C.O.LT.
Customer Outdoor Lighting

RATE

<u>Monthly Charge</u>	<u>Lumens</u>	<u>Type Light</u>	<u>KW Rating</u>
\$ 5.51*	2,500	Incandescent	.201
6.56**	3,500	Mercury Vapor	.126
7.57**	7,000	Mercury Vapor	.207

*Restricted to those fixtures in service on December 15, 1971.

**Restricted to those fixtures in service on October 12, 1982.

SPECIAL CONTRACT FOR ELECTRIC SERVICE TO
WEST VIRGINIA PULP AND PAPER COMPANY

ENERGY CHARGE

2.589 cents per KWH

APPENDIX B

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 9780 DATED JULY 21, 1987.

The amount of additional revenues to maintain the rate of return was computed as follows:

	<u>PSC ORDER Page 19</u>	<u>As Corrected</u>
Unbilled Revenues	\$5,583,000	\$5,583,000
MULTIPLY BY:		
Tax Rate	X .38785	X .38785
	<u>\$2,165,000</u>	<u>\$2,165,000</u>
ITC	192,000	2,434,000
Subtotal	<u>\$2,357,000</u>	<u>\$4,599,000</u>
Actual Rate of Return	<u>.0998</u>	<u>.0998</u>
AMOUNT REQUIRED TO MAINTAIN EARNINGS	<u>\$ 235,000</u>	<u>\$ 459,000</u>

The reduction in revenue requirements was calculated as follows:

	<u>PSC ORDER Page 18</u>	<u>As Corrected</u>
Reduction in Taxes	\$ 12,523,000	\$ 12,523,000
LESS:		
Commission 48/46% Reduction	<452,000>	<452,000>
Amount Required to Maintain Earnings	<235,000>	<459,000>
Superfund Tax	-0-	<108,000>
Subtotal	<u>\$ 11,836,000</u>	<u>\$ 11,504,000</u>
MULTIPLY BY:	X 1.633587	X 1.633587
REVENUE REQUIREMENTS REDUCTION	<u>\$ 19,335,000</u>	<u>\$ 18,793,000</u>

The additional Phase Two reduction was calculated as follows:

	<u>PSC ORDER Page 20</u>	<u>As Corrected</u>
Total Reduction at 34%	\$19,335,000	\$18,793,000
Phase One Reduction	<u>9,760,000</u>	<u>9,760,000</u>
PHASE TWO REDUCTION	<u>\$ 9,575,000</u>	<u>\$ 9,033,000</u>